

SAN FRANCISCO PUBLIC LIBRARY



3 1223 07805 2124

San Francisco

Office of the Auditor

5/S



San Francisco Public Library

Government Information Center  
San Francisco Public Library  
100 Larkin Street, 5th Floor  
San Francisco, CA 94102

REFERENCE BOOK

*Not to be taken from the Library*

## AIRPORT COMMISSION:

### Concession Review of D-Lew Enterprises, LLC, dba Il Fornaio Caffè del Mondo

City and County of San Francisco

Office of the Auditor

D  
REF  
647.9579  
Sa578cd1



October 30, 2007



# City and County of San Francisco

Office of the Controller – City Services Auditor

## **AIRPORT COMMISSION:**

**Concession Review of D-Lew  
Enterprises, LLC, dba Il Fornaio  
Caffe del Mondo**



October 30, 2007

## **CONTROLLER'S OFFICE CITY SERVICES AUDITOR**

The City Services Auditor was created within the Controller's Office through an amendment to the City Charter that was approved by voters in November 2003. Under Appendix F to the City Charter, the City Services Auditor has broad authority for:

- Reporting on the level and effectiveness of San Francisco's public services and benchmarking the city to other public agencies and jurisdictions.
- Conducting financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operating a whistleblower hotline and website and investigating reports of waste, fraud, and abuse of city resources.
- Ensuring the financial integrity and improving the overall performance and efficiency of city government.

The audits unit conducts financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

We conduct our audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office (GAO). These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

Audit Team: Elisa Sullivan, Audit Manager  
Robert Tarsia, Audit Manager  
Lorita Chung, Associate Auditor





**CITY AND COUNTY OF SAN FRANCISCO**  
**OFFICE OF THE CONTROLLER**

**Ed Harrington**  
**Controller**

**Monique Zmuda**  
Deputy Controller

October 30, 2007

San Francisco Airport Commission  
P.O. Box 8097  
San Francisco International Airport  
San Francisco, CA 94128

President and Members:

The Controller's Office, City Services Auditor, presents its report concerning the concession review of D-Lew Enterprises, LLC, dba Il Fornaio Caffè del Mondo (D-Lew). D-Lew has a 10-year lease, through November 9, 2010, with the Airport Commission of the City and County of San Francisco to operate Il Fornaio Caffè del Mondo, a bistro with two locations on Airport property.

**Reporting Period:** July 1, 2002, through June 30, 2005

**Rent Paid:** \$225,018

**Results:**

D-Lew Enterprises reported gross revenues of \$3,565,520 and paid rent of \$225,018 to the Airport. However, D-Lew did not report \$34,244 of gross revenues for catering services provided to the Airport Department and owes \$2,739 in additional rent, as well as a service charge of 1.5 percent per month on that amount.

The responses from the Airport and D-Lew Enterprises are attached to this report. The Controller's Office, City Services Auditor will be working with the department to follow up on the status of the recommendations made in this report.

Respectfully submitted,

*Harriet Richardson*

Harriet Richardson  
Director of Audits

cc: Mayor  
Board of Supervisors  
Civil Grand Jury  
Public Library

*Page intentionally left blank.*

# INTRODUCTION

---

## **Background**

D-Lew Enterprises, LLC (D-Lew) has a 10-year lease with the San Francisco Airport Commission (Commission) of the City and County of San Francisco (City) to operate Il Fornaio Caffè del Mondo, a bistro with two locations at the San Francisco International Airport. The lease commenced on April 24, 2000, and will expire on November 9, 2010. The lease requires D-Lew to pay the Airport Department (Airport) the greater of a minimum annual guarantee or a tiered percentage rent of six to ten percent of its gross revenues. The percentage rent tiers are contingent on the amount of D-Lew's total gross revenues per lease year. During the review period, the minimum annual guarantee was \$61,000.

## **Scope**

The purpose of this review was to determine if D-Lew complied with the reporting and payment provisions of its lease with the Commission. Our review covered the period starting July 1, 2002, through June 30, 2005.

## **Methodology**

To conduct the review, we examined the applicable terms of the lease and the adequacy of D-Lew's procedures for collecting, recording, summarizing, and reporting its gross revenues to the Airport. To determine whether D-Lew accurately reported its gross revenues to the Airport, we tested on a sample basis D-Lew's monthly sales summaries, daily sales reports, cash register tapes, and bank deposit records. We also compared the gross revenues reported to the Airport with the gross revenues reported to the California Board of Equalization for selected quarters.

We conducted this review in accordance with Generally Accepted Government Auditing Standards. We believe that we adequately planned and performed the review to achieve the objective and that the evidence obtained provides a reasonable basis for our finding and conclusion, as required by these standards.

# RESULTS

---

## Summary

### **D-Lew Enterprises Underreported Gross Revenues by \$34,244 and Underpaid \$2,739 in Rent to the Airport**

From July 1, 2002, through June 30, 2005, D-Lew reported gross revenues of \$3,565,520 and paid rent of \$225,018 to the Airport. Exhibit 1 shows the reported gross revenues and rent paid to the Airport.

---

**EXHIBIT 1 Gross Revenues and Rent Paid July 1, 2002, Through June 30, 2005**

---

Reporting Period	Gross Revenues	Rent Paid
July 1, 2002, through June 30, 2003	\$1,054,360	\$ 66,855
July 1, 2003, through June 30, 2004	1,209,570	74,641
July 1, 2004, through June 30, 2005	1,301,590	83,522
<b>Total</b>	<b>\$3,565,520</b>	<b>\$225,018</b>

---

Sources: Airport accounting monthly sales reports and FAMIS cash receipts report generated by Office of the Controller, Accounting Operations and Systems Division.

However, the Airport's accounting records only show that it collected \$218,773. This resulted from the Airport issuing various credit memos during the review period to D-Lew totaling \$6,245 in exchange for catering services provided to the Airport. Subsequent to the review period, the Airport issued \$25,205 in credit memos to D-Lew in exchange for catering services provided to the Airport. The City Charter, Section 3.105 states that all disbursements of funds in the custody of the Treasurer must be authorized by the Controller. The Charter further states that no officer or employee shall bind the City to expend money unless there is a written contract or other instrument and unless the Controller certifies that sufficient unencumbered balances are available in the proper fund to meet the payments under such contract or other obligation as these become due.

When the Airport issued credit memos in exchange for catering services, it circumvented the City's purchasing and payment procedures and therefore prevented the Controller from authorizing and certifying these expenditures. To properly account for these transactions and ensure transparency of the Airport's expenditures, the Airport should have recorded the total rent due as collected and



recorded separate expenditures, resulting in checks issued, for the catering services it purchased.

Further, D-Lew did not include the catering services in its gross revenues subject to rent. According to its lease agreement, gross revenues includes the full amount of all orders for products or services accepted by the tenant if on, about or from the premises, whether or not to be filled or performed at any other place. D-Lew owes \$723 for rent during our review period and \$2,016 for the period from July 1, 2005, through June 30, 2006, plus a service charge of 1.5 percent per month. The following table shows the credit memos issued and the total additional rent owed.

<b>EXHIBIT 2</b>	<b>Credit Memos Issued to D-Lew for Catering Sales and Rent Owed to Airport</b>
------------------	---

Reporting Period	Catering Sales	Rent Owed
July 1, 2002, through June 30, 2005	\$ 9,041 <sup>a</sup>	\$ 723
July 1, 2005, through June 30, 2006	25,203	2,016
<b>Total</b>	<b>\$34,244</b>	<b>\$2,739</b>

<sup>a</sup> This amount consists of \$6,245 of credit memos to D-Lew's rent and \$2,796 of credit memos to other amounts D-Lew owed, such as electricity, water, and telecommunications.

Sources: Credit memos issued by Airport project management and FAMIS cash receipts report generated by Office of the Controller, Accounting Operations and Systems Division.

## Recommendations

The Airport Department should:

1. Discontinue the practice of issuing credit memos in exchange for services from Airport tenants.
2. Collect from D-Lew Enterprises \$2,739 in underpaid rent, plus a service charge of 1.5 percent per month.
3. Review its events records to identify other instances where it issued credit memos in exchange for services and collect any rents underpaid if the tenant did not include the revenue in its gross revenues.
4. Ensure its accounting records reflect the correct rent revenues received and catering expenditures incurred.

*Page intentionally left blank.*

# **ATTACHMENT: DEPARTMENT RESPONSE**

---

The Airport has reviewed a draft of the Audit of D-Low Enterprises, LLC, conducted by the City Services Auditor, and submits the following responses to the Auditor's findings and recommendations:

**Audit Recommendation No. 1: "The Airport Department should discontinue the practice of using credit memos in exchange for services from Airport tenants."**

**Airport Response:**

Previously, with the approval of the City Attorney's Office, the Airport Commission adopted Resolutions Nos. 87-0093 and 96-0016 which authorized the issuance of rental credits for tenant reimbursements under \$5,000 without the approval of the Airport Commission and, if over \$5,000, with the approval of the Airport Commission.

Previous practice was undertaken under these guidelines approved by the City Attorney's Office and established by the Airport Commission. However, the Airport will follow the Controller's direction and has now discontinued this practice for catering services and instead issues check payments for such services rendered by Airport tenants. Additionally, the Airport has budgeted for this expense in the FY 2007-08 Budget.

The Airport also agrees that its tenants must properly account for rental credits received. The Lease Agreement between the Airport and each concessionaire defines "Gross Revenues" as the "retail price of all merchandise sold and services rendered ... whether such sales be for cash or on credit, and in case of sales on credit, whether or not payment is actually made..." The Airport agrees that payment for goods and services by means of a credit memo is a form of sale on credit which should be included in a concessionaire's Gross Revenues from which rental payments are calculated. The Airport will ensure that its accounting records reflect an accurate amount of Gross Revenues as defined in the Lease Agreements, and will also advise any concessionaire receiving a credit memo as payment for goods or services, to include the amount of that sale in its Gross Revenues.

**Audit Recommendation No. 2: "The Airport Department should collect from D-Low Enterprises \$2,739 in underpaid rent, plus a service charge of 1.5 percent per month."**

**Airport Response:**

The Airport will collect the underpaid rent from D-Low Enterprises.

**Audit Recommendation No. 3: "The Airport Department should review its events records to identify other instances where it issued credit memos in exchange for services and collect any rents underpaid if the tenant did not include the revenue in its gross revenues."**

**Airport Response:**

The Airport will review its events records to identify other instances in which current concessionaires provided goods or services in exchange for rental credits to ensure that such sales are properly included in the applicable concessionaire's Gross Revenues (see Response to Audit Recommendation No. 1 above). If any such concessionaire underpaid rent due to such sales not being included in Gross Revenues, the Airport will collect the underpaid rent that is due.

**Audit Recommendation No. 4: "The Airport Department should ensure its accounting records reflect the correct rent revenues received and catering expenditures incurred."**

**Airport Response:**

See Response to Audit Recommendation No. 1 above.



## ATTACHMENT: D-LEW RESPONSE

---

# D-Lew Enterprises, LLC

July 19, 2007

Ms. Harriet Richardson  
Director of Financial Audits  
Office of the Controller, City Services Auditor  
City Hall, Room 476  
1 Dr. Carlton B. Goodlett Place  
San Francisco, CA 94102

### D-LEW ENTERPRISES, LLC RESPONSE TO JUNE 12, 2007 AUDIT REPORT

Dear Ms. Richardson:

This letter is D-Lew Enterprises' response to the audit results issued by the City and County of San Francisco, Office of the Controller, City Services Audit in the Concussion Review of D-Lew Enterprises, LLC dba Il Fornaiio Caffè del Mondo Financial Audit Report and dated June 12, 2007. D-Lew Enterprises does not agree with the findings of the report and does not agree to pay the \$2,739 amount plus services charges assessed.

The report asserts that D-Lew Enterprises did not report \$34,244 in gross revenue for catering services provided to the airport and concludes that D-Lew Enterprises owes \$2,739 in additional rent plus service charges of 1.5 percent per month on that amount. D-Lew Enterprises did receive revenues of \$34,244 for catering services provided to the airport and did not report that revenue to the airport for the purposes of calculating rent. We believe that this is appropriate under the terms of the Lease Agreement.

Section 4.1(a)(i) of the Lease Agreement by and between D-Lew Enterprises, LLC and City and County of San Francisco dated September 1999 defines "Gross Revenues" as "The retail price of all food and beverage products sold and services rendered in, on, about or from the Premises or from such other locations on Airport operated by Tenant...plus...the full amount of all orders for products or services accepted by Tenant II, on, about or from the Premises, whether or not to be filled or performed at any other place, and the full amount of orders accepted by Tenant elsewhere, but to be filled or performed in, on, about or from the Premises." "Premises" is defined as the physical locations of the Il Fornaiio stores identified as AE-90 and GS-60.

Products sold and catering services performed by D-Lew Enterprises, LLC for the Airport are not rendered in, on, about the Premises and food and beverage orders are not accepted by D-Lew Enterprises in, on, about the Premises. Food and beverage orders for catering events are accepted by D-Lew Enterprises, LLC elsewhere, but they are not filled or performed in, on, about or from the Premises. In fact, most of the catering events that D-Lew Enterprises, LLC has fulfilled have transpired in the Airport Museum. For these events, D-Lew Enterprises typically coordinates the delivery of food and beverage directly from outside catering vendors to the desired site for the event, which has never been the Premises. Therefore, under the terms of the

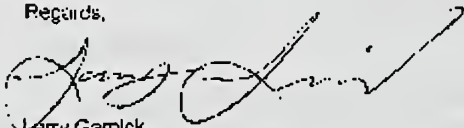
5 Thomas Mellon Circle, Suite 220, San Francisco, CA 94134

Lease Agreement, it is not appropriate to report these revenues as Gross Revenues for purposes of rent calculations.

The form, and the spirit, of the Lease Agreement is for D-Law Enterprises to pay rent equal to a percentage of the Gross Revenues generated in the Premises actually occupied by our Il Fornaiello Carlo del Monno establishments. The Agreement specifically excludes food and beverage sales and services not rendered at those establishments. Clearly, revenue that D-Law Enterprises, LLC generates from catering events occurring at locations not at the airport with food and beverages that are not supplied by the Il Fornaiello establishments located at AE-00 and GS-00 would not fall under the definition of Gross Revenues under the License Agreement. The mere fact that some such catering events occurred in an airport location does not change the nature of those catering revenues to fall within the definition of Gross Revenues under the License Agreement.

D-Law Enterprises, LLC has an outstanding, long-standing, mutually beneficial business relationship with the Airport and the City and County of San Francisco and we abide by the terms and conditions of the License Agreement. We intend to keep our positive relationship in good standing and we hope that this letter helps resolve the issue raised in the audit report.

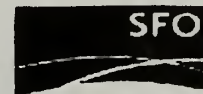
Regards,



Larry Gamick  
Acting CFO  
D-Law Enterprises, LLC

5 Thomas Mellon Circle, Suite 220, San Francisco, CA 94134

# ATTACHMENT: DEPARTMENT RESPONSE



San Francisco International Airport

August 28, 2007

Mr. Larry Garnick  
D-Lew Enterprises, LLC  
5 Thomas Mellon Court, Suite 220  
San Francisco, CA 94134

Re: Audit of Food and Beverage Lease No. 99-0292K ("Lease"), by and between  
D-Lew Enterprises, LLC, d/b/a Il Forno Caffè del Mondo, as Tenant  
("D-Lew"), and San Francisco International Airport ("Airport"), as Landlord

Dear Mr. Garnick:

This letter is in response to your letter of July 19, 2007 to Ms. Harriet Richardson, Director of Financial Audits, regarding a recent audit performed by the Office of the Controller for the City and County of San Francisco ("Audit Report").

The Airport has reviewed your letter and provides the following response to the issue of D-Lew's underreporting of gross revenues to the Airport.

As noted in the Audit Report, D-Lew did not include revenues derived from catering services in calculating gross revenues. This failure violates Lease Section 4 (Rent). D-Lew's letter attempts to obfuscate the issue by stating that catering services performed by D-Lew for the Airport are not rendered in, on, or about the Lease premises and that food orders are not accepted by D-Lew, but by a separate legal entity. As such, D-Lew reasons that these concession revenues are not part of D-Lew's gross revenues.

Regardless of D-Lew's reading of the Lease, D-Lew is the sole beneficiary of the catering services through its acceptance of the rental credits for those services. A rent credit is monetary in nature and is considered revenue for the purposes of calculating and reporting gross revenues.

The Airport accepts the Audit Report's finding that D-Lew underreported its gross revenues and owes the Airport a total of \$2,739.00 in additional rent, plus a service charge of 1.5 percent per month. Please make immediate payment to the Airport Accounting Department. Failure to make said payment shall constitute a default under Lease Section 15 (Default).

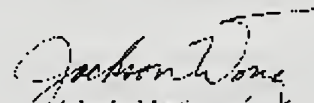
<sup>1</sup> See Audit Report page 2 and 3.

Mr. Larry Garmek  
August 24, 2007  
Page 2

Please note nothing herein shall constitute a waiver of any rights of the Airport related to the matters addressed herein, including all remedies available to it under the Lease, as well as the commencement of legal action.

I am confident that you will join the Airport in moving quickly to resolve the issues raised in this letter and the Audit Report. If you have questions regarding this issue, please contact David L. Dunn of Revenue Development and Management at 650.821.4500.

Very truly yours,

  
John L. Martin  
Airport Director *for*

cc: David L. Dunn  
Office of the Controller, City and County of San Francisco  
Office of the City Attorney  
Scott Rodrick, D-Lew Enterprises, LLC





